I.C.C. Docket No. 02-0864
Staff Ex. 33.0
Public

SUREBUTTAL TESTIMONY TO SBC ILLINOIS

OF

ROBERT F. KOCH

RATES DEPARTMENT

TELECOMMUNICATIONS DIVISION

ILLINOIS COMMERCE COMMISSION

ILLINOIS BELL TELEPHONE COMPANY

FILING TO INCREASE UNBUNDLED LOOP AND NONRECURRING RATES

DOCKET NO. 02-0864

MARCH 5, 2004

Q. Please state your name and business address.

A. My name is Robert F. Koch and my business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. Are you the same Robert Koch that filed Direct Testimony and Rebuttal Testimony in this proceeding?

A. Yes.

Q. What is the purpose of this surrebuttal testimony?

A. I will address the surrebuttal testimony of August H. Ankum, Ph.D., regarding imputation issues.[1] Upon review of Dr. Ankum's surrebuttal testimony, I do not propose any changes to my recommend imputation tests. I will also address certain cost issues discussed in the joint rebuttal testimony of Brian F. Pitkin and Steven E. Turner.[2] Having reviewed the rebuttal testimony of Mr. Pitkin and Mr. Turner, I continue to hold the opinion that the introduction of controlled environmental vaults ("CEV's") and an additional type of digital loop carrier ("DLC") improves the efficiency of SBCI's modeled UNE loops. In doing so, I agree with certain of Messrs. Pitkin and Turner's arguments regarding expected efficiencies that were not realized when this equipment was implemented in LoopCAT.

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[1] Joint CLEC Ex. 3.1
[2] AT&T Ex. 2.1

Imputation

Q. Please describe Dr. Ankum's criticisms regarding your proposed imputation test.

A. Dr. Ankum disagrees with my proposed imputation test in two significant ways. First, he criticizes my position, set forth in my direct and rebuttal testimony, that nonrecurring charges should not be a part of the imputation test. [3] Second, Dr. Ankum disagrees with my position that retail related expenses should not be a part of the imputation test. As SBCI did not include these expenses in the tests that it proposed, I did not address the appropriateness of including the expenses until my rebuttal testimony to intervenors.[4] At that time, I noted that all of the retail related expenses that I am aware of are shared and common costs, and therefore not appropriate for inclusion in the imputation test.[5]

Q. Please provide a comparison of your imputation tests to those provided by Dr. Ankum.

A. The tests that I have submitted in this proceeding are contained in my rebuttal testimony to SBC.[6] The most recent iteration of Dr. Ankum's imputation test is contained in Attachment 2 to his surrebuttal testimony. The most significant difference is that Dr. Ankum performs imputation

[3] *See* Staff Ex. 4.0; 16.0; 24.0.
[4] Staff Ex. 16.0
[5] Staff Ex. 16.0 at 8.

tests only for basic business network access lines, while I provide tests for ISDN, COPTS, and STF pair-at-a-time access lines in addition to basic business access lines, each of which must independently pass imputation. Further, Dr. Ankum does not perform an imputation analysis of Staff's proposed rates. Therefore, our approaches can be compared only with respect to basic business access lines.

The table below compares the imputation margin (the difference between imputed costs and revenues) under Dr. Ankum's approach and my own, using SBCI's proposed UNE rates. The negative value of the margins indicates that SBCI's rates fail imputation in each of the three access areas in both of our analyses. Although this result is consistent, the margins by which SBCI's fail our respective tests are significantly different. These differences can be attributed mainly to the inclusion of nonrecurring costs and revenues, as well as retail related expenses in Dr. Ankum's tests.

Imputation Margin Using SBCI Rates

	Access Area A	Access Area B	Access Area C
Mr. Koch's Test	$ (X.X)	$ (X.X)	$ (X.X)
Dr. Ankum's Test	$ (11.73)	$ (22.20)	$ (22.80)

[6] Staff Ex. 24.0, Schedule 24.1(using SBCI's proposed UNE rates); Schedule 24.2 (using Staff's proposed rates).

A. Nonrecurring Charges

Q. Please describe Dr. Ankum's criticism of your position regarding the exclusion of nonrecurring charges from the imputation test.

A. Dr. Ankum mistakenly characterizes my position concerning inclusion of nonrecurring charges based upon one statement in my rebuttal testimony to intervenors.[7] In my rebuttal testimony to the CLECs, I stated that:

> Line connection and service order charges are cost based, and therefore do not rely upon the recurring network access line rate for recovery. As such, it is not necessary to include their costs and revenue in the analysis of network access line recurring charges.[8]

Dr. Ankum states that he does not understand this statement, and describes his reasoning for inclusion of such charges in his surrebuttal testimony.[9] In short, Dr. Ankum argues that, if the non-recurring charges are omitted from the analysis, revenues may appear to cover costs while in actuality they do not.

Q. What is your opinion regarding Dr. Ankum's criticisms?

A. Dr. Ankum concedes that he did not understand the arguments I made in rebuttal testimony to intervenors regarding the impropriety of inclusion of non-recurring charges in the imputation test. Accordingly, in the interest of clarity, I will expand on this point. In my rebuttal testimony to the CLECs, I sought to make clear that *retail* rate structures are designed in such a way that non-recurring charges are intended to fully recover the non-recurring

[7] Joint CLEC Ex. 3.1 at 9, citing Staff Ex. 16.0 at 7.
[8] Staff Ex. 16.0 at 7

costs of establishing service, and that recurring rates are intended to fully recover the recurring costs of provisioning service. As such, the imputation test for the retail business access line need not analyze the costs and revenues for non-recurring charges. Non-recurring charges should be analyzed on a stand-alone basis. If it were found that SBC was charging less for its retail non-recurring services than it costs to provision such services, that issue can be addressed as well. However, it is not germane to the issue of whether retail recurring charges recover their imputed costs.

Q. Are there any additional reasons why nonrecurring costs should not be included in the specific imputation tests for this proceeding?

A. Yes. In my rebuttal testimony to SBCI, I indicate an additional reason why nonrecurring charges should not be included in the imputation test. Specifically, I indicate that there are serious concerns with the complexity of an imputation test that includes nonrecurring charges.[10] Nonrecurring charges vary depending on how UNEs are provisioned. By introducing these charges into the test, it would be also necessary to develop a set of assumptions as to what nonrecurring charges are applicable. I cannot fault Dr. Ankum for not addressing the issue because it was raised simultaneously to the filing of his surrebuttal testimony. However, for the sake of completeness, I am compelled to note that this concern also

[9] Joint CLEC Ex. at 9, 10.

exists, and would undoubtedly be a source of conflict on a going-forward basis if nonrecurring charges were to be included in the test.

Q. How would the inclusion of nonrecurring costs and revenues impact your imputation analysis?

A. Dr. Ankum proposes the inclusion of $7.52 in imputed nonrecurring costs and $2.53 in nonrecurring revenue in his imputation tests, for a net effect of an additional $4.99 in costs in each access area. As I have indicated previously, I developed two sets of imputation tests for this proceeding. One set of tests assumes that SBCI's UNE rates are accepted [11]and the other set of tests is under the scenario that Staff's UNE rates are accepted.[12] The table below shows the impact of including Dr. Ankum's proposed nonrecurring cost and revenue in the imputation analysis of Staff's proposed rates.[13] The difference between the current margin in my imputation analysis of Staff's rates, and Dr. Ankum's net nonrecurring cost increase, is the amount by which Staff's proposed UNE rates would now fail the test, and would thus require retail rate increases.

	Access Area A	Access Area B	Access Area C
Staff Test Margin	$ X.X	$ X.X	$ X.X
Net Nonrecurring Costs	$ 4.99	$ 4.99	$ 4.99
Difference	$ (X.X)	$ (X.X)	$ (X.X)

10 Staff Exhibit 24.0 at 25
11 Id., Schedule 24.1
12 Id., Schedule 24.2

B. Retail Related Expenses

Q. How do you respond to Dr. Ankum's concerns regarding the inclusion of retail related expenses in the imputation test?

A. Dr. Ankum correctly states that I testify that: "all retail related incremental costs of provisioning the service are recovered via UNE loop and port elements."[14] In making this statement I intended to indicate that there are no incremental costs that are somehow not included in the UNE, but are applicable in a retail environment. This is a significant point for the purposes of developing an imputation, because Section 13-505.1 of the PUA defines imputed costs as follows:

> *The imputed costs of a service for purposes of this test shall be defined as the sum of:*
>
> *(1) specifically tariffed premium rates for the noncompetitive services or noncompetitive service elements, or their functional equivalent, that are utilized to provide the service;*
>
> *(2) the long-run service incremental costs of facilities and functionalities that are utilized but not specifically tariffed; and*
>
> *(3) any other identifiable, long-run service incremental costs associated with the provision of the service.*[15]

It is clear that the imputation test is to include only specifically tariffed rates plus incremental costs. The full import of my statement was to

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[13] See Attachment 2 to Joint CLEC Exhibit 3.0 at page 2 for Dr. Ankum's calculated nonrecurring costs and revenues; see Schedule 24.2 to Staff Exhibit 24.0 for the imputation margin for business network access lines.

[14] Staff Ex. 16.0 at 8

[15] 220 ILCS 5/13-505.1

indicate that the retail related expenses that Dr. Ankum included in the test are not *incremental* costs, but rather *shared and common* costs. Although not specifically stated in the sentence that Dr. Ankum cited, the paragraph in which my statement was made also indicates that the only retail related expenses that I am aware of are shared and common costs, and not incremental costs. Dr. Ankum, however, does not address this statement or any implications it may have regarding retail related expenses being allowed for in the statutory definition of imputed costs.

Q. Is it your opinion that Section 13-505.1 of the PUA does not allow for any shared and common costs to be included in the imputed cost of a service?

A. Not entirely. Although I am not a lawyer, it appears to me that, inasmuch as shared and common costs are included in a specifically tariffed noncompetitive rate that is an element utilized in the provisioning of the service subject to imputation, such costs are properly included in the imputed cost. In the case of the business access line test, no party to this proceeding disputes that UNE loop rates should be utilized as part of the test. UNE loop rates include the TELRIC of the element plus a mark-up for shared and common costs. However, nowhere else in the definition of imputed costs in Section 13-505.1 of the PUA are shared and common costs specifically allowed. It appears to me, therefore, that any adder to the test, above and beyond a specifically tariffed rate, must be an incremental cost, rather than a shared or common cost.

Q. What is your opinion regarding Dr. Ankum's assertions that there are no retail related expenses in UNE rates?

A. Dr. Ankum is correct. As was mentioned previously, I indicated that all retail related incremental costs are included in UNE rates. Perhaps a better way to make this clear is to point out that there are *no* incremental costs associated with retail access line provisioning that are *avoided* in the wholesale environment. It was not my intention to imply that retail avoided costs are somehow a part of UNE rates.

The issue, as I see it, is that I disagree with Dr. Ankum regarding the inclusion of these costs because they are not incremental costs, which in my opinion are the only costs directly included for purposes of imputation. Based on Dr. Ankum's response, it appears that he considers the inclusion of shared and common costs to be totally justified. Dr. Ankum's argument for the inclusion of retail related expenses in the imputation test indicate these costs are, in fact, shared and common costs that are explicitly excluded from rate development for UNEs.[16] Although this statement is true, it does not justify the inclusion of such costs in an imputation test.

[16] Joint CLEC Exhibit 3.1 at 11.

Q. Is it possible that, by not including retail related expenses, a service could pass an imputation test when, in fact, it is not a profitable venture?

A. Yes, if a carrier that relies on UNEs were unable to price its services in a way that its retail related expenses would be covered, than it would not be profitable to compete. However, that is not to say that the imputation test was done incorrectly. The reason a carrier may find that it is not profitable to compete may be because of inefficiencies in its own operations. The imputation test does not guarantee that operations for a competitor will be profitable. Rather, it is only a mechanism to protect against a price squeeze. Nothing in Section 13-505.1 or Code Part 792 guarantees a certain level of contribution towards shared and common costs. By insisting that a measure of minimum retail related costs are included in the imputation test, Dr. Ankum effectively is trying to guarantee just that.

Q. What is the impact on consumers of accepting Dr. Ankum’s position regarding the inclusion of retail related costs in the imputation test?

A. The impact on consumers is not certain. However, any benefit consumers would receive in increased competition would necessarily be at the expense of higher retail rates. If including retail related expenses would cause a service that would otherwise pass the test to now fail, then SBCI’s retail rates would have to increase as a result. However, it is not certain whether added competition would result or not. This is because retail related expenses are unique to each competing carrier. If it was profitable for a carrier to compete prior to the inclusion of retail related expenses into the test, than the increase in SBCI's retail rates would allow them to become even more profitable at the expense of SBCI's retail consumers. If it was not profitable for a carrier to compete previously, then the retail rate increase might be expected to induce it to enter the marketplace. However, there is no guarantee that it would be profitable for this carrier even after the SBCI retail rate increase.

Consider an example. Assume that a retail business access line passes imputation by a margin of $2 without retail related expenses included. If a certain carrier calculates its retail related expenses at $4, than it would not be profitable to compete for customers of this service because it would lose $2 per customer per month as a result. However, if another carrier can keep its retail related expenses down to $1, than it would be profitable for it to compete. Assuming that the retail related expenses used in the imputed test were $3, it would be necessary for SBCI to increase its rates by $1. In such a circumstance, the first carrier would still not be able to compete, and the second carrier would have the ability to increase its rates and continue to be competitive with SBCI. This example shows that it is quite conceivable that the impact on consumers would only be an increase in retail rates. Clearly, if all CLECs were profitable before the inclusion of retail related expenses in the imputation test, the only possible benefit of such an inclusion would be the ability of these carriers to increase their profit margin.

Q. For the services subject to imputation in this proceeding, is it the case that inclusion of retail related expenses would impact the results of the tests?

A. Because retail related expenses are placed on the imputed cost side of the test, the outcome of my tests did not change at all under the scenario that SBCI's proposed rates were accepted. They would continue to fail, and by an increasing margin. However, the inclusion of these expenses under the scenario that Staff's UNE rates were accepted would cause basic network access line rates to fail imputation in all three access areas. The table below shows that the retail related expenses, as calculated by Dr. Ankum, exceed the margins by which Staff's proposed rates pass imputation.[17] The difference between these two numbers is the amount by which Staff's proposed UNE rates would now fail the test, and would thus require retail rate increases.

	Access Area A	Access Area B	Access Area C
Staff Test Margin	$ X.X	$ X.X	$ X.X
Retail Related Expense	$ 3.82	$ 5.89	$ 6.53
Difference	$ (X.X)	$ (X.X)	$ (X.X)

[17] See Attachment 2 to Joint CLEC Ex. 3.0 at page 2 for Dr. Ankum's calculated retail related expenses; see Schedule 24.2 to Staff Ex. 24.0 for the imputation margin for business network access lines.

Q. What would be the impact on SBCI's retail revenue of allowing Dr. Ankum's proposed nonrecurring charges and retail related expenses into the imputation test?

A. Schedule 33.01 to this surrebuttal testimony calculates the impact on SBCI's retail revenue of accepting Dr. Ankum's nonrecurring charge and retail related expense proposals under two scenarios: (1) if the Commission where to accept SBCI's proposed UNE rates; and (2) if the Commission where to accept Staff's proposed UNE rates. In the first scenario, it is a simple calculation of net increase in imputed costs under Dr. Ankum's proposal being multiplied by annual demand to develop the annual revenue impact. Schedule 33.01 shows that this impact is $173 million, which is in addition to the revenue impact of accepting SBCI's UNE rate proposal of $98 million, as calculated in Schedule 24.03 to my rebuttal testimony to SBCI. Thus, The total of accepting both Dr. Ankum's imputation analysis and SBCI's proposed UNE rates is an increase in SBCI's retail revenue of $271 million annually ($173 million + $98 million).

Under the second scenario, Staff's proposed UNE rates pass imputation by a significant margin prior to any adjustments based on Dr. Ankum's proposal. This margin represents the amount by which UNE rates could be increased before they fail imputation. Therefore, this margin must be subtracted from the net imputed cost increase under Dr. Ankum's proposal before being multiplied by annual demand to develop the revenue impact. Schedule 33.01 shows that the impact of accepting Dr. Ankum's imputation proposal and Staff's UNE rates is an increase in SBCI's retail revenue of $131 million annually.

Q. What is your opinion of the impacts calculated in Schedule 33.01?

A. Regardless of whether Staff's or SBCI's UNE rates are accepted by the Commission, the inclusion of Dr. Ankum's proposed imputed costs have a significant negative impact on SBCI's retail customers, who would have to foot the bill of between $131 million and $271 million in retail business network access line rate increases. Naturally, SBCI would benefit if its customers did not switch carriers as a result of the rate increases it would be forced to file. Such a result would most probably not occur, though. As SBCI's rates increase, its customers would naturally gravitate to a competitor that is not constrained by imputation. Therefore, it is reasonable to assume that the main beneficiary of accepting Dr. Ankum's imputation proposal would be the CLEC community, at the expense of SBCI and its customers. An impact as significant as that calculated in Schedule 33.01 should be avoided if at all possible, especially considering that this impact is solely the result of accepting the viewpoint of one witness over that of another witness in this proceeding.

SBCI's Introduction of New RT Types

Q. Please explain the position of Messrs. Pitkin and Turner in regard to the impact of including CEV's and 448 DLC remote terminals in LoopCAT?

A. Messrs. Pitkin and Turner argue that the inclusion of this remote terminal equipment has the impact of increasing the cost per line, and is therefore an inappropriate adjustment.[18] Messrs. Pitkin and Turner allege that this adjustment will increase costs per line, but do not specifically identify what numbers in LoopCAT leads them to this conclusion. The only explanation Messrs. Pitkin and Turner give regarding why SBCI's approach is not appropriate is that it is not consistent with the proposed CEV adjustment that SBC used in California.[19] It is not clear why these witnesses believe that this lack of consistency necessarily indicates that SBCI's current approach is improper. The only explanation Messrs. Pitkin and Turner give as to why costs increase as the 448 DLCs are implemented into LoopCAT is that fill factors do not simultaneously increase as would be expected.[20]

Q. Do you disagree with Messrs. Pitkin and Turner regarding the inclusion of these types of RT equipment?

[18] AT&T Ex. 2.1 at 51-54.
[19] Id. at 52.
[20] Id. at 54.

A. Yes. I completely disagree with their assertions that the inclusion of additional RT equipment increases cost per line. In my rebuttal testimony to SBCI, I pointed to the relevant portions of LoopCAT that are affected by the inclusion of this equipment, and found that the costs decreased. I endorsed the company's decision to make these modifications, as such modifications appear efficient, having decreased the cost per line. The table below clearly shows the impact of these modifications as yielding a reduction in cost per line:

TELRIC Cost for Remote Terminal Equipment for 2 Wire Analog Loops

	2002 Filing	2004 Filing*	Reduction	% Reduction
Access Area A	$ X.X	$ X.X	$ X.X	15.27%
Access Area B	$ X.X	$ X.X	$ X.X	30.13%
Access Area C	$ X.X	$ X.X	$ X.X	31.63%

* TELRIC Cost for 2004 Includes Cost of RT Equipment and CEV

Q. Do you agree with Messrs. Pitkin and Turner that fill factors should have increased as a result of the inclusion of the 448 DLC RT?

A. Yes. I anticipated that the reduction in costs per line would be at least partially due to an increase in fill-factors. However, the most significant impact seems to be that the channel unit investment has decreased for the 2016 DLC and the 672 DLC. I am not certain why this is the case, but the overall impact is a lower cost for RT equipment per line.

Q. Have your recommendations changed as a result of reading the rebuttal testimony of Messrs. Pitkin and Turner?

A. No, not at this time. However, I am now concerned as to why fill-factors are not increasing with SBCI's inclusion of additional RT equipment. I would be interested to hear SBCI's reasoning as to why this is not the case. Based on whatever response SBCI makes regarding this issue, it may be necessary to revise LoopCAT to reflect more efficient capacity utilization. At this time, I am not certain as to what the appropriate value of the adjustment should be. However, any increase in fill-factors for RT equipment would cause the TELRIC for UNE loops to decrease.

Q. Does this conclude your Surrebuttal Testimony?

A. Yes.